Supreme Court, U.S.
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No. 94-632

In The

Supreme Court of the United States

October Term, 1994

MAURICE SPORTING GOODS, INC.,

Petitioner,

v.

MAXWAY CORPORATION and DANNERS, INC., by and through their OFFICIAL COMMITTEE OF UNSECURED CREDITORS,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

11 U.S.C. §546(a), as applied by the court below, provides that preference actions under §547 of the Bankruptcy Code must be brought within two years of the appointment of a trustee under the Bankruptcy Code; 11 U.S.C. §1107(a) provides that a Chapter 11 debtor-in-possession is "[s]ubject to any limitations on a trustee serving in a case under this chapter". The issue presented is whether a debtor-in-possession, acting as a trustee under §1107(a), is subject to the two-year statute of limitations imposed by §546(a)(1), or, irrespective of the plain language of §1107(a), that a debtor-in-possession is free to bring preference actions at any time until the case is closed or dismissed, which may be five, ten, twenty, or even more years after the commencement of the bankruptcy case.

LIST OF PARTIES

The parties to the proceedings below were the Petitioner, Maurice Sporting Goods, Inc., and the Respondents, Maxway Corporation and Danners, Inc., acting by and through their Official Committee of Unsecured Creditors.

Maurice Sporting Goods, Inc. ("Maurice") is a corporation organized under the laws of the state of Illinois. Maurice is 100% privately held. Maurice has no subsidiaries, other than one wholly-owned subsidiary.

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PETITIONER'S REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Maurice Sporting Goods, Inc., the Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-entitled proceeding on June 23, 1994.

I. ENACTMENT OF THE BANKRUPTCY REFORM ACT OF 1994 HEIGHTENS AND SUPPORTS THE NEED FOR THE COURT TO GRANT CERTIORARI.

A. CONGRESS' CLARIFICATION OF CODE §546(a) MEANS THE CIRCUIT COURTS' CONSTRUCTIONS THEREOF ARE RELEVANT AND CONGRESS' CONSTRUCTION SHOULD BE GIVEN RETROACTIVE EFFECT.

A bankruptcy trustee's power to recover a preference under Code §547 is subject to Code §546(a)'s statute of limitations. Maurice contends that a debtor-in-possession, acting as a trustee in bringing an avoidance action, is subject to the statute of limitations. At the time this action was commenced, the version of Code §546(a) in effect ("Original §546(a)"), which is set forth in the Appendix at App.-1, was ambiguous. Original §546(a) was still in effect when the Fourth Circuit rendered its decision which is directly contrary to the decisions of the Second, Third, Ninth, and Tenth Circuits.

Maurice filed its Petition for Certiorari on October 6, 1994. On October 22, 1994, the President signed the Bankruptcy Reform Act of 1994, H.R. 5116, P.L. 103-394. Section 216 of P.L. 103-394, which is set forth in the Appendix at App.-2, clarifies Code §546(a) ("Clarified §546(a)(1)") to remove the ambiguity at issue here. P.L. 103-394's legislative history includes the House Judiciary Committee's report, which contains a section-by-section analysis of the bill. The report, relevant portions of which are reproduced in the Appendix at App.-3, unequivocally demonstrates that Congress intended to clarify the law and Congress always intended for the two-year limitation to apply to a debtor-in-possession. H. Rep. 103-835, to accompany H.R. 5116, 140 Cong.Rec. 142 (daily edition, October 4, 1994), H. 10764, 10768.

Similarly, the legislative history in the Senate, relevant portions of which are reproduced in the Appendix at App.-4, demonstrates even more strongly that Congress intended to clarify the law and always intended for the two-year statute of limitations to apply to a debtor-in-possession. 104 Cong.Rec. 144 (daily edition October 6, 1994), S. 14461, 14465.

"Subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction." *Red Lion Broadcasting Co. v. F.C.C.*, 395 U.S. 367, 380-381, 89 S.Ct. 1794, 1802, 23 L.Ed.2d 371, 383 (1969); *also see Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572, 596, 100 S.Ct. 800, 814, 63 L.Ed.2d 36, 54 (1980).

When P.L. 103-394 was enacted, there was a clear conflict at all levels of the federal court system over the construction of Code §546(a)(1). A conflict among the courts indicates that a subsequent amendment clarifies, rather than changes, the existing law. *See In re Fielder*, 799 F.2d 656, 660 (11th Cir. 1986) (*per curiam*); *May Department Stores Co. v. Smith*, 572 F.2d 1275, 1278 (8th Cir.) (*per curiam*), *cert. denied*, 439 U.S. 837, 99 S.Ct. 122, 58 L.Ed.2d 134 (1978).

A clarification of the law is to be applied retroactively to the construction of the original statute. *In re Adams*, 761 F.2d 1422, 1427 (9th Cir. 1985). In *Adams*, the debtor drove his vehicle while legally intoxicated, striking Betty Moraes' vehicle and injuring her. Moraes filed an adversary proceeding, contending that Adams was liable for her injuries. At this time, courts were divided whether driving while intoxicated, without more, constituted conduct sufficiently willful and malicious to warrant a finding of non-dischargeability under Code §523(a)(6).

On July 10, 1984, two months *after* the entry of judgment in favor of Moraes, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"), P.L. 98-353, 98 Stat. 392. BAFJA §371 added Code §523(a)(9), which specifically excepted from discharge a claim arising from a debtor's operation of a motor vehicle while legally intoxicated. However, pursuant to §553(a) thereof, BAFJA was "effective to cases filed 90 days after the date of enactment."

In §523(a)(9)'s legislative history, Congress recognized the conflict and stated that the amendment was intended to clarify the law. 130 Cong.Rec. (daily ed. June 29, 1984) (statements of Rep. Rodino), *reprinted in* 1984 U.S. Code Cong. & Ad. News 576, 577. Based upon the split among the courts and Congress' stated intent to clarify the Code, the Ninth Circuit held that the Congress' clarification applied retroactively to the construction of §523(a)(6) and affirmed the district court.

In this action, Debtors' first contention is that P.L. 103-394 renders the circuit courts' interpretation of Original §546(a)(1) irrelevant. To the contrary, by *clarifying* rather than substantively changing the law, Congress demonstrated that decisions of the Second, Third, Ninth, and Tenth Circuits are correct and their construction should be applied by all courts, including this Court, retroactively.

If Debtors' contention were to have any validity, it would be that the Fourth Circuit's decision has lost any significance since its reading of Original §546(a) has been rejected by Congress. However, even that statement would be incorrect. As discussed in Maurice's motion for a stay of execution, Debtors executed on the judgment of the courts below and currently hold $576,728.01 seized from Maurice. Thus the Fourth Circuit's decision retains

its importance to the parties until it is reversed and those funds are returned to Maurice. Moreover, as demonstrated below, it remains relevant to other parties inside and outside the Fourth Circuit.

B. IF CONGRESS' CLARIFICATION OF §546(a) IS NOT RETROACTIVELY APPLIED, THE ISSUE WILL CONTINUE TO EXIST FOR DECADES AND THE NEED FOR CERTIORARI TO RESOLVE THE CONFLICTING CIRCUIT DECISIONS CONTINUES.

As set forth in the Appendix at App.-5, §702 of P.L. 103-394 provides that, with exceptions not relevant here, P.L. 103-394 applies to cases commenced after the date of enactment. H.R. 5116, §702, 103d Cong., 2d Sess., 140 Cong.Rec. (daily edition October 4, 1994), H. 10752, 10763.

The filing of a petition in bankruptcy commences a "case". *See* Code §301. By contrast, an avoidance action is not a "case" but, instead, is known as an "adversary proceeding", *see* Bankruptcy Rule 7001, and is commenced by filing a complaint. As illustrated in *In re Excel Enterprises, Inc.*, 83 B.R. 427, 430 (Bankr. W.D. La. 1988), the difference between "cases" and "adversary proceedings" is critical (holding that the law of an adversary proceeding is the law in effect on the date the underlying bankruptcy case was commenced).[1]

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[1] As recognized by this Court in *Union Bank v. Wolas*, 502 U.S. ___, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991), amendment of Code §547(c)(2) (the amendment in question in *Excel*) was a *substantive* change in the law. By contrast, §216 of the 1994 Act merely clarifies existing law with respect to the applicability of the 2-year statute of limitations to a debtor-in-possession. Thus,

Under the Fourth Circuit's erroneous decision, the only limit on a debtor-in-possession's ability to bring an avoidance action is the close of the case, which may be 15 years or even longer after commencement of the case. If construction of Original §546(a) is not governed by §216 of P.L. 103-394, then it has no effect in any bankruptcy case commenced before October 22, 1994.[2] A single Chapter 11 case may spawn hundreds of adversary proceedings; the issue may arise in each adversary proceeding in any Chapter 11 case commenced prior to October 22, 1994 regardless of whether that adversary proceeding is commenced on October 21, 1994; October 23, 1994; or October 23, 2004.[3] In the Fourth Circuit, there will continue to be no limitation on a debtor-in-possession's ability to commence an avoidance action.[4] Moreover, in each circuit which has not addressed the issue, untold hours of judicial resources will be wasted litigating the construction of Original §546(a)(1) and the effect of P.L. 103-394. This

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as demonstrated by *In re Adams, supra*, this section is not intended to suggest that §216 of the P.L. 103-394 does not apply retroactively to the construction of Original §546, but, instead, merely to identify the effect of a non-retroactive application.

[2] According to statistics compiled by the Administrative Office of the United States Courts, 71,637 cases filed under Chapter 11 were pending as of June 30, 1994.

[3] According to statistics compiled by the Administrative Office of the United States Courts, 120,603 adversary proceedings were pending as of June 30, 1994.

[4] *See* Transcript of the hearing in *Field v. Maryland Federal Savings and Loan Association (In re Anton Motors, Inc.)*, Adversary No. 94-1408 (Bankr. D. Md. Oct. 27, 1994), where the Honorable James Hill denied defendant's motion to dismiss the plaintiff's complaint as barred by Code §546(a)(1) and held that, notwithstanding enactment of P.L. 103-394, the decision herein controls in all Chapter 11 cases in the Fourth Circuit.

Court should grant certiorari to resolve the split among the circuits.

C. A SPLIT AMONG THE CIRCUITS IS INTOLERABLE AND WILL ONLY LEAD TO GREATER LITIGATION AND CONFUSION.

Debtors' second contention that a split among the circuits in the interpretation of Original §546(a) is tolerable. In support thereof, Debtors contend that subsequent to the *Zilkha* decision in 1990, "bankruptcy practitioners have advised debtors-in-possession to file avoidance actions within two years of the entry of the order for relief. Practically speaking then, the conflict in the circuit courts of appeal affects only that number of Chapter 11 cases which were filed more than two years before the December 19, 1990 *Zilkha* decision and in which the debtors are still in possession." *Debtors' Brief*, p. 6.

Notwithstanding that it is wholly unsupported by the record, Debtors' contention is irrelevant and incorrect. To begin with, although *Zilkha* was the first decision by a circuit court, it was not the first published decision to recognize that a debtor-in-possession is subject to §546(a)(1). *See, e.g., In re Lill*, 116 B.R. 543, 546 (Bankr. N.D. Ohio 1990) (published prior to the running of the statute of limitations herein). Obviously, the existence of *Zilkha*-like authority did not deter Debtors.

Moreover, a review of the decisions cited by Debtors shows that, following *Zilkha*, either bankruptcy practitioners have failed to advise debtors-in-possession or that debtors-in-possession have ignored such advice, since debtors-in-possession keep bringing avoidance actions more than two years after the order for relief, thereby forcing the waste of countless hours of limited judicial resources addressing the issue and prejudicing creditors

and defendants alike by improperly extending the life of Chapter 11 cases. As Debtors reported in their brief, a majority of published bankruptcy court decisions have decided the issue contrary to Congress' intent; there is no reason to conclude that bankruptcy courts will do anything but continue to misconstrue Original §546(a) and encourage debtors-in-possession to perpetuate the waste of time and creditors' money.

In sum, it is abundantly clear that unless certiorari is granted, this issue will continue to arise. Countless hours and millions of dollars which could otherwise be distributed to creditors will be spent litigating the construction of Original §546(a) and the effect of Clarified §546(a). This result and a continued split among the circuits is intolerable in light of Congress' unmistakable dictates.

II. IN LIGHT OF CONGRESS' CLARIFICATION, THE GRANT OF CERTIORARI AND SUMMARY REVERSAL OF THE FOURTH CIRCUIT IS APPROPRIATE.

As noted herein, a refusal by this Court to grant certiorari will leave an erroneous decision on the record which will continue to affect courts within and without the Fourth Circuit and will cause the further waste of judicial resources in other circuits and creditors' money. The Court can prevent such a waste of resources by granting certiorari and simultaneously reversing or vacating the decision of the Fourth Circuit pursuant to Supreme Court Rule 16.1 and 28 U.S.C. §2106. In light of Congress' clarification of §546(a), this Court can provide substantial guidance to the lower courts by granting certiorari and summarily reversing the Fourth Circuit's clearly erroneous decision.

Adoption of a new regulation has been recognized as an appropriate reason to exercise this power, *see United States v. State of Michigan*, 623 F.2d 448 (6th Cir. 1980), *modified on other grounds*, 653 F.2d 277, 281, *cert. denied*, 454 U.S. 1124, 102 S.Ct. 971, 71 L.Ed.2d 110, *on remand*, 520 F.Supp. 207 (W.D. Mich. 1981); use of such power is appropriate here, where Congress has merely clarified the law consistent with the construction of most of the circuits. Alternatively, the Court should order the Fourth Circuit to reconsider its decision herein in light of the subsequent clarification of the law by Congress. *See Bureau of Economic Analysis v. Long*, 454 U.S. 980, 102 S.Ct. 468, 70 L.Ed.2d 242 (1980).

By summarily reversing the Fourth Circuit, the Court will ensure that Original §546(a) is construed the same as Clarified §546(a) in Chapter 11 cases with respect to a debtor-in-possession. Thus, (1) as originally intended by Congress, the two-year statute of limitations will apply to a debtor-in-possession; (2) Congress' clarification will be given effect; (3) the rights of creditors and potential defendants will be the same, regardless of whether a Chapter 11 bankruptcy case is commenced before or after October 22, 1994; (4) judicial resources will be preserved by preventing further litigation; and (5) expeditious administration of Chapter 11 cases will be encouraged.

CONCLUSION

For the reasons cited herein, Maurice Sporting Goods, Inc., Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the above-captioned case on June 23, 1994. In the event the petition is granted, Maurice prays that the judgment of

the United States Court of Appeals for the Fourth Circuit be reversed and that this action be remanded with instructions that this action be dismissed with prejudice.

Respectfully submitted this 17th day of November, 1994.

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An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of –

(1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202 of this title; or

(2) the time the case is closed or dismissed.

11 U.S.C. §546(a) (1978, as amended)

SEC. 216. LIMITATION ON AVOIDING POWERS.

Section 546(a)(1) of title 11, United States Code, is amended to read as follows:

"(1) the later of:

"(A) 2 years after the entry of the order for relief; or

"(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (1); or".

H.R. 5116, §216, 103d Cong., 2d Sess., 140 Cong.Rec. (daily edition October 4, 1994), H. 10752, 10757

Section 216. Limitation of avoiding powers

This section clarifies section 546(a)(1) of the Bankruptcy Code which imposes a 2-year statute of limitations within which an appointed trustee must bring an avoidance action. The purpose of the statute of limitations is to define the period of time that a party is at risk of suit. This section defines the applicable statute of limitations as 2 years from the entry of an order for relief or 1 year after the appointment of the first trustee if such appointment occurs before the expiration of the original 2-year period. This section is not intended to affect the validity of any tolling agreement or have any bearing on the equitable tolling doctrine where there has been fraud determined to have occurred. The time limits are not intended to be jurisdictional and can be extended by stipulation between the necessary parties to the action or proceeding.

H. Rep. 103-835, to accompany H.R. 5116, 140 Cong.Rec. 142 (daily edition, October 4, 1994), H. 10764, 10768

The House has added a new provision, section 216, to the Bankruptcy Reform Act and I would like to clarify my belief as to the purpose and intent of including this section. It is my understanding that the current statute of limitations contained in section 546(a) of title 11 requires an avoidance action be brought within 2 years of the filing of a chapter 11 petition, even if a trustee or other estate representative is subsequently appointed or the case is later converted. Thus, under current law, if a trustee or other estate representative is appointed after the current 2 year statute of limitations expires, any actions which the trustee may discover are time-barred. This amendment has arisen from the perceived need to provide a period of time for a later appointed bankruptcy estate representative to investigate and institute actions.

This is yet another area of bankruptcy law that has been the subject of extensive litigation recently, and I commend the Congress for its attention to this problem. This amendment should prevent prejudice against potential defendants that would result in having to defend stale actions and should encourage estate representatives to investigate and resolve actions earlier in a bankruptcy case, thus minimizing estate expenses and maximizing the value of the estate to all creditors.

104 Cong.Rec. 144 (daily edition October 6, 1994), S. 14461, 14465 (statements of Senator Hatch)

SEC. 702, EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE. Except as provided in subsection (b), this Act shall take effect on the date of enactment of this Act.

(b) APPLICATION OF AMENDMENTS. (1) Except as provided in paragraph (2), the amendments made by this Act shall not apply with respect to cases commenced under title 11 of the United States Code before the date of enactment of this Act.

H.R. 5116, §702, 103d Cong., 2d Sess., 140 Cong.Rec. 142 (daily edition October 4, 1994), H. 10752, 10763